Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Goldberg | Analyst: LuAnna Hass | Bill Number: AB 205

Related Bills: See Prior Analysis | Telephone: 845-7478 | Amended Date: July 3, 2003

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: Filing Status/Domestic Partners

____	DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ________________________.
____	AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
X	AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended June 3, 2003.
X	FURTHER AMENDMENTS NECESSARY.
____	DEPARTMENT POSITION CHANGED TO ________________________.
X	REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED June 3, 2003, STILL APPLIES.
____	OTHER - See comments below.

SUMMARY

This bill would allow domestic partners to file personal income tax returns as either 1) married filing joint, or 2) married filing separate.

In addition, this bill would make changes to various California laws regarding domestic partners, including the creation of community property rights. These changes do not affect the department and are not discussed in this analysis.

SUMMARY OF AMENDMENTS

The July 3, 2003, amendments made various technical changes. These amendments do not impact the department. For convenience, the department's existing concerns and an updated fiscal impact are provided below. The remainder of the department's analysis of the bill as amended June 3, 2003, still applies.

POSITION

Pending.

Board Position:			Legislative Director	Date
______ S	______ NA	______ NP	Brian Putler	07/03/03
______ SA	______ O	______ NAR		
______ N	______ OUA	X PENDING		

ANALYSIS

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update. However, the department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- As stated under "State/Federal Law" in the March 25, 2003, analysis, for purposes of computing limitations based upon adjusted gross income (AGI), the taxpayer would use the AGI that is required to be shown on the federal tax return for the same taxable year. Therefore, federal AGI determines, among other tax items, the 2% floor on itemized deductions, the AGI floor on medical expenses, the state percentage of the federal child and dependent care credit, and the phase out of exemption credits. Since domestic partners are required to file separate federal tax returns, it is unclear what the federal AGI figure would be in order to compute the limitations.
- California personal income tax returns use the federal AGI to begin the calculation of state income tax. Since domestic partners would file separate federal tax returns, it is unclear what the federal AGI figure would be for domestic partners filing jointly on the state tax return.
- The department uses automated systems to compare taxpayer return information to files received from other state and federal agencies, including the Internal Revenue Service (IRS). These automated systems search through IRS records by Social Security Number and name and compare information on the taxpayer's federal income tax return to the information on the California income tax return. Since current law generally requires the filing status of the taxpayer for the state tax return to be the same filing status as on the federal return, the systems have the ability to verify joint returns based on the primary taxpayer's information. Since domestic partners are required to file separate federal income tax returns and this bill would allow domestic partners to file a joint state income tax return, the department anticipates a significant delay in the ability of the automated systems to compare taxpayer information. The systems would be required to run through the federal information more than once as the systems search for the primary taxpayer and the secondary taxpayer individually because each taxpayer would have a separate return at the federal level. The systems would need additional programming and testing prior to being operational.
- A provision of this bill would create community property laws for domestic partners. It appears the intent of the author is to allow domestic partners to have the same community property privileges and burdens as those given to civil marriage partners. This general provision could be construed to allow domestic partners to be treated as joint owners for all provisions regarding income taxes, including division of income and credits. However, if this is the intent, department staff would recommend a clarifying amendment within the Revenue and Taxation Code to specify the exact provisions where domestic partners would be considered spouses. Department staff is available to work with the author's office to draft amendments to resolve this concern.

TECHNICAL CONSIDERATIONS

The term "registered domestic partners" is undefined within the provision of the bill pertaining to the Revenue and Taxation Code. To ease administration, department staff suggests an amendment that would add a cross-reference to Family Code Section 297, which describes registered domestic partners. In addition, current income tax law requires spouses that file joint returns to be married as of the last day of the taxable year. For consistency purposes, department staff suggests an amendment that would require domestic partners to be registered as of the last day of the taxable year. Amendment 1 is provided.

FISCAL IMPACT

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

The department anticipates customer service contacts from taxpayers seeking clarification of the filing requirements. These costs are estimated to be $54,000.

Further, the automated systems that compare federal and state tax information for audit purposes would need additional programming and testing. Costs to program and test the systems are estimated to be $58,000. As a result of the programming the department would experience delays when the automated systems compare federal and state information because the systems would need to search the records individually to match both domestic partners.

ARGUMENTS/POLICY CONCERNS

This bill states domestic partners may file either a joint return or file separately "by applying the standards applicable to married couples under federal income tax law." Since under federal law married persons (with narrow exceptions) are prohibited from filing as head of household or single, this bill could be construed to require domestic partners to file joint returns at the state level and no longer allow domestic partners to file single or married head of household returns at the state level. Although this treatment would be consistent with married couples, domestic partners who currently file as head of household typically pay less income tax than if they were to file as married filing jointly.

This bill could have an impact on federal income tax law since those laws rely on each states' laws regarding married persons and their property. Currently, since California is a community property state, spouses who file separate federal income tax returns are required to split the community incomes of each spouse to be claimed on each return. This bill would create community property laws for domestic partners that are similar to existing laws for civil marriage. Federal income tax law does not recognize domestic partners as married. However, since federal law relies on state laws regarding community property, domestic partners would be required to claim half of each others' community income on their separate federal returns (single filing status). For example, under current federal law domestic partners with a filing requirement must file separate returns and pay the tax attributable to the individual returns. Assume Partner A has federal AGI of $50,000 and Partner B has federal AGI of $100,000. For the 2002 tax year, assuming each partner takes a standard deduction and one exemption, Partner A would have a tax of $7,760, and Partner B would have a tax of $22,013, for a total of **$29,773**. Since the federal tax laws generally follow the state community property laws, the domestic partners would continue to file individual federal returns. However, they would be required to split the community income of the partners. In the example above, Partner A would claim $25,000 of his/her income and $50,000 of Partner B's income. Partner B would do the same. Therefore, each partner would pay tax on an AGI of $75,000. Again, assuming they each take a standard deduction and claim one exemption, each partner would pay $14,510 in tax for a total of **$29,020** for both partners. Therefore, depending on the individual circumstances of the taxpayer, this bill could result in domestic partners paying less federal income tax.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 205
As Amended July 3, 2003

AMENDMENT 1

On page 15, line 6, after "partners" insert:

, as described in Section 297 of the Family Code and who are registered as domestic partners as of the close of the taxable year,